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C O N F I D E N T I A L SECTION 01 OF 02 BUDAPEST 001139

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DEPT FOR EUR/CE, EB/OMA, INR/EC; USDOC FOR SAVICH; TREASURY
FOR ERIC MEYER, JEFF BAKER, LARRY NORTON; USEU FOR HAARSAGER

E.O. 12958: DECL: 11/24/2013
TAGS: ECON EFIN PREL HU
SUBJECT: WAITING FOR THE OTHER SHOE TO DROP: THE IMPACT OF
THE FINANCIAL CRISIS ON THE REAL ECONOMY

REF: A. BUDAPEST 1059
¶B. BUDAPEST 1006

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D)

¶1. (C) Summary. Although there is little agreement among experts regarding Hungary's growth rate for 2009, most business leaders remain pessimistic about the future. Some sectors in the real economy have already begun experiencing the negative effects of Hungary's economic slowdown, while others may not feel the impact until next year. Effects on the real economy are likely to become clear in January, when companies will begin producing flash reports that reflect fourth quarter results. AmCham and other business organizations are increasingly urging the government to use the international stabilization program as an opportunity to enact economic reforms, but they are pessimistic about their chances for success. End summary.

¶2. (U) Given the large number of external variables, there is little consensus among economists and macroeconomic analysts regarding the length and severity of the economic downturn in Hungary. A rapid return to growth in Western Europe and assistance to European automakers could mean a speedier recovery in Hungary, which depends on Germany and other Western European markets as a destination for exports. But continued low domestic consumption levels and a slow return to normalcy for financial markets may mean longer term problems for Hungary.

¶3. (U) The GOH currently estimates that output will contract by about 1 percent in 2009. More pessimistic outlooks - including the Central Bank in its latest inflation report - estimate a 2 percent decline in GDP for 2009, while others predict a smaller decline or even a slight increase in growth next year. The IMF forecasts that growth will not return to its estimated potential of 3 percent, however, until after
¶2011.

¶4. (U) Many businesses outside of the financial sector that do not rely heavily on external credit have thus far only experienced limited effects of the economic slowdown. That said, most business leaders are pessimistic - even by Hungarian standards - about their prospects for 2009.

SOME COMPANIES ALREADY HIT...

¶5. (SBU) Some elements of the real economy have already begun to experience the economic downturn's negative effects. In the expectation of difficult times ahead, companies have begun cutting costs and reevaluating less profitable business units. Media and advertising firms are losing business due to slashed marketing budgets. Similarly, technology companies report that orders are down as companies delay equipment upgrades and postpone IT investment.

Manufacturers, particularly those supplying the auto industry, have also experienced a large falloff in orders.

¶6. (C) The availability of credit and financing continues to be a problem for businesses. Citigroup's Head of Corporate Banking Laszlo Balassy notes that in both the corporate and consumer banking sectors, "only the best borrowers" have access to funds. In addition, M&A attorney Andre Mecs told us that he is aware of at least two acquisitions that were canceled because of financing problems. FCS reports an increasing number of requests from U.S. companies (and/or their suppliers) for assistance with financing. For example, FCS is working to help the importer of Arizona Tea, which has orders from Hungarian retailers, but is unable to obtain financing locally to make its purchases from the U.S. source. Other U.S. companies have asked for FCS assistance in putting them in touch with the EBRD, as other forms of investment financing have dried up.

¶7. (U) In recent weeks, the number of reported layoffs, production line closures and temporary stoppages have increased significantly. On November 25, Alcoa, which operates four factories in Hungary, announced the layoff of 734 workers, due to falling demand for cars. Other U.S. companies, including GE and Delphi have also recently announced layoffs. A popular financial website has even created a counter to track the number of people layed-off in Hungary as a result of the global economic crisis. Since the beginning of October, the site estimates 6,383 people have been layed-off from 55 different companies. Opposition FIDESZ Party President Viktor Orban has publicly raised the prospect of layoffs ultimately reaching 250,000.



...OTHERS EXPECT THE PAIN TO COME SOON

¶8. (SBU) Even those businesses not yet feeling the direct impact of the economic slowdown are preparing for a difficult 2009, and many are developing contingency plans to prepare for "worst case scenarios." In addition to cutting expenses, we have heard for some time that many foreign manufacturers and banks were no longer reinvesting profits in Hungary; that trend is likely to accelerate unless the current environment improves. Unemployment is also expected to continue to rise. A legal consultant told us that a number of companies are preparing to institute large-scale collective dismissals.

¶9. (C) The continued decline in domestic consumption is expected to significantly impact consumer electronic and other businesses that rely on consumer spending. For example, mobile service provider T-Com has noted an increase in the bad debt ratio of consumers, and expects a slowdown in the mobile telephone handset replacement rate.

A CLEARER PICTURE IN JANUARY

¶10. (C) A number of companies have indicated that "we won't know how bad things really are" until the end of January, when companies begin releasing reports for the fourth quarter of 2008. Some of the more pessimistic observers believe that this is when "panic will begin" once these figures fully quantify for the first time how far company revenues have declined.

¶11. (C) Comment. Most businesses we have spoken to believe that 2009 will be a "tough year." Many business leaders also believe that if Hungary does not take meaningful steps to reduce government expenditures, lower the tax burden on labor, and reform the pension and social welfare system, Hungary will face an even more difficult future. Hungarian National Bank President Andras Simor tells us privately that he is making these points to government decision-makers but admits candidly "I'm failing." The sense of many major investors is that at best Hungary will lose ground to other countries in the region, and at worst it could face another

financial crisis as investors lose confidence in the country. AmCham Hungary and other business chambers are increasing efforts to urge the government to use the IMF/EU/World Bank stabilization package as an opportunity to enact difficult but necessary reforms. Former Finance Minister Lajos Bokros has been pressing this point, but believes the governing party is "unable to correctly diagnose the disease" and thus "incapable of finding the right treatment." Many business leaders remain similarly skeptical about the government's willingness and ability to move forward on reform, and for many Hungarians the past months have been a "foreign attack" rather than the logical consequence of bad policy. Without a sober recognition of what happened - and what could happen again without corrective action - one business contact warns that "the IMF package will be like giving alcohol to an alcoholic." End comment.

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